

DETERMINING A COMPANY'S ABILITY TO PAY REGULATORY FINES

Authorities don't really want to drive companies bankrupt, and the best way for organisations to avert disaster is to engage experienced advisers at the DPA stage

For most companies facing allegations of criminal wrongdoing, negotiating a deferred prosecution agreement (DPA) is much preferable to the prospect of a conviction if the case goes to court. A finding that the company has committed a criminal offence such as fraud, bribery or money laundering can bring consequences including disbarment from contracts with a government and its state-owned businesses, and similar repercussions in other states.

The guidelines for settlement, set in the US by the US Sentencing Commission and in the UK by the Sentencing Council for England and Wales, consider the pecuniary gain the misdeed has generated, for which the starting point is the accounting revenue minus directly and readily attributable costs. A company cannot benefit from wrongdoing so associated gains must be disgorged. In addition, penalties are assessed as multiples as high as four times the ill-gotten gains.

The severity of a settlement can seem particularly harsh for a company in a downturn. Multipliers applied to profits earned in better times could place a company in extreme financial distress. Consider an oil and gas business profiting from an indiscretion when oil prices were soaring, but having to pay the penalty when margins have collapsed. Or a pharmaceutical company that invested billions to develop a drug that now sells at a high margin. A settlement based on multipliers applied to gross profits in isolation could be unsustainable, meaning restructuring, capital-raising or even bankruptcy.

The goal of prosecutors in the US and UK is similar. The US Sentencing Guidelines (USSG) impose "sanctions upon organizations and their agents, (that) taken together, will provide just punishment, adequate deterrence, and incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct". While the UK Sentencing Council's (UKSC) guidelines are less prescriptive, they stipulate the level of the fine should "fulfill the objectives of punishment, deterrence and removal of gain". With the exception of companies which are largely criminal enterprises – such as Ponzi schemes – neither agency wishes to put companies out of business.

Culpability scores

Once the gain from the alleged illicit activity has been calculated a culpability score is determined based on such factors as whether a cover-up was attempted or high-level officers were party to the violation, or, on the other hand,

whether the company self-reported, compensation was made and remediation rendered. Depending on the score, the multiplier applied to the gain can be as high as four times for the most blameworthy.

The guidelines allow penalties to be adjusted based on ability to pay. According to the USSG a fine should "avoid substantially jeopardizing the continued viability of the organization". The UKSC considers "the value, worth or available means of the offender". The agencies will also consider payment in instalments. Furthermore, there is increasing recognition by different national authorities of the need to co-ordinate settlements where the same misdeeds are being prosecuted to reach an appropriate overall penalty and avoid so-called 'piling on'.

The 'ability to pay' study

Building an argument about an organisation's ability to pay involves determining the consequences of the penalty on its ability to invest, retain employment levels and maintain the financial ratios necessary to access capital. Our debates with prosecutors regarding fines in DPAs are about risk, viability of the organisation and the point at which risk become unacceptable.

A convincing ability to pay study must be, above all, comprehensive and credible. Any suspicion that something has been left out compromises the study's – and the company's – credibility. Ultimately, the company needs to engage an objective adviser practiced in the process, picking through records to unearth relevant issues – such as outstanding claims, sources of funding, profit projections, contingent assets, liabilities and investments to ensure the company can answer all the authorities' questions.

Due to the complexity of assessing ability to pay the authorities normally engage their own experts to assess what they are being told. An adviser known to the agencies to be thorough, experienced and credible can change an authority's tone from suspicious to judicious – from looking for what has been left out to what might have been overlooked.



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